

ORIGINAL

NEW APPLICATION



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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

MIKE GLEASON, Chairman
WILLIAM A. MUNDELL
JEFF HATCH-MILLER
KRISTIN K. MAYES
GARY PIERCE

Arizona Corporation Commission

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ARIZONA CORPORATION COMMISSION
DOCKET CONTROL

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In the matter of:

JAMES LEROY COSTELLO
(CRD#1501345), a married man, individually
and doing business as COSTELLO &
ASSOCIATES-FINANCIAL, an Arizona
registered trade name, and
LINDA S. COSTELLO, spouse of JAMES
LEROY COSTELLO

Respondents.

DOCKET NO. S-20627A-08-0485

**NOTICE OF OPPORTUNITY FOR HEARING
REGARDING PROPOSED ORDER TO
CEASE AND DESIST, ORDER FOR
RESTITUTION, ADMINISTRATIVE
PENALTIES AND OTHER AFFIRMATIVE
ACTION**

NOTICE: EACH RESPONDENT HAS 10 DAYS TO REQUEST A HEARING

EACH RESPONDENT HAS 30 DAYS TO FILE AN ANSWER

The Securities Division ("Division") of the Arizona Corporation Commission ("Commission") alleges that respondent JAMES LEROY COSTELLO, a married man, doing business as COSTELLO & ASSOCIATES-FINANCIAL, has engaged in acts, practices, and transactions that constitute violations of the Securities Act of Arizona, A.R.S. § 44-1801 *et seq.* ("Securities Act").

I.

JURISDICTION

1. The Commission has jurisdiction over this matter pursuant to Article XV of the Arizona Constitution and the Securities Act.

II.

RESPONDENTS

2. JAMES LEROY COSTELLO ("COSTELLO") may be referred to as "Respondent". COSTELLO is a married man residing in Phoenix, Arizona.

3. LINDA S. COSTELLO ("L. COSTELLO") was at all relevant times the spouse of Respondent COSTELLO. L. COSTELLO may be referred to as "Respondent Spouse". L. COSTELLO is joined in this action under A.R.S. § 44-2031(C) solely for purposes of determining the liability of the marital community.

4. At all times relevant, COSTELLO was acting for his own benefit and for the benefit or in furtherance of the marital community.

5. At all relevant times, COSTELLO transacted business under the trade name "COSTELLO & ASSOCIATES-FINANCIAL" ("C&AF") which was registered with the Arizona Secretary of State on April 26, 1999.

III.

FACTS

6. From about May 1999 until March 2007, COSTELLO offered for sale unregistered securities, in the form of promissory notes and/or investment contracts, to investors located in Arizona.

7. COSTELLO raised at least \$195,000 from at least 15 investors. The investors believed they were purchasing viatical settlement investment contracts ("viaticals"). COSTELLO sold to the investors securities, in the form of promissory notes and/or investment contracts.

8. COSTELLO was a registered securities salesman in Arizona from May 23, 1986 until September 15, 2003.

9. Currently, COSTELLO is a licensed insurance producer with the state of Arizona. COSTELLO was initially licensed by the Arizona Department of Insurance to sell insurance products in 1981.

1 10. COSTELLO solicited investments from investors. COSTELLO told offerees that he
2 would use investor funds to purchase viaticals on their behalf. Specifically, COSTELLO told
3 investors that he worked with someone who identified the securities that COSTELLO would
4 purchase. In addition, COSTELLO represented to investors that he would arrange for collection of
5 payment of benefits on behalf of his investors when benefits were repaid on their investments.

6 11. Although COSTELLO represented to investors that their funds would be used to
7 purchase viaticals, COSTELLO did not provide investors with any documents to evidence they were
8 actually invested in viaticals.

9 12. In one instance, an offeree and investor requested proof (e.g. documents) to confirm
10 that the funds he invested with COSTELLO were actually used to purchase viaticals. COSTELLO
11 did not provide the investor with any documentation to support his claim that he had actually
12 purchased a viatical on behalf of the investor. To date, COSTELLO has not provided his investors
13 with documents to confirm that their funds were actually used to purchase viaticals.

14 13. An offeree and investor asked COSTELLO to provide the names of other investors
15 and the insurance companies that issued the viaticals. However, COSTELLO did not provide the
16 investor with the requested information.

17 14. In another instance, COSTELLO showed an investor a copy of an insurance
18 policy and represented to the investor that the policy was evidence of the viatical COSTELLO
19 purchased on the investor's behalf.

20 15. The only document each of COSTELLO'S investors received was an untitled
21 document which listed the investor's name, the amount of their investment, the terms of their
22 investment, the date and amount of the investor's return on their investment. The investor and
23 COSTELLO signed the document. At least two investors believed this document to be a
24 "promissory note".

25 16. COSTELLO told at least one offeree and investor that the opportunity to invest with
26 him in viaticals was only available to select individuals.

1 17. COSTELLO also told offerees and investors that is group consisted of 18 to 20
2 investors in Arizona which were part of a larger nationwide organization.

3 18. COSTELLO told offerees and investors that their investments were risk-free and
4 guaranteed. COSTELLO also represented to investors that a state insurance fund would protect them
5 from loss of their investment.

6 19. COSTELLO promised offerees and investors a 50 to 100% total return on their
7 investments, including principal and interest. COSTELLO represented to investors in their
8 promissory notes the date their investments would be repaid.

9 20. COSTELLO misled an investor to believe that the securities he offered were
10 exempt from registration.

11 21. In at least two instances, COSTELLO misrepresented to offerees that he was
12 registered to sell securities after his registration to sell securities had terminated. In another instance,
13 COSTELLO told an investor he was a "certified investment adviser".

14 22. In some instances, COSTELLO solicited investors to purchase viaticals through
15 his insurance business, CA&F. At all relevant times, CA&F was not registered as a securities dealer
16 in Arizona.

17 23. To date, COSTELLO has not repaid many of his offerees and investors.
18 COSTELLO has given his offerees and investors varying explanations for his failure to repay their
19 investments. In a few instances, COSTELLO told an investor that he was unable to repay his
20 investment because COSTELLO was not receiving payment from the insurance companies for the
21 viaticals.

22 24. In at least one instance, COSTELLO told an offeree and investor that he was unable
23 to repay his investment because COSTELLO was being investigated and audited by the United
24 States Internal Revenue Service and sued by an investor.

25 25. On another occasion, COSTELLO promised an investor a higher return on his
26 investment because of a delay in repaying the investment.

26. Although COSTELLO has not repaid many of his investors, COSTELLO has partially repaid some investors. In spite of this, in at least one instance COSTELLO asked an offeree and investor to invest additional funds even though the investor has not been entirely repaid for his initial investment.

27. Although COSTELLO told offerees and investors that he would use their investments to purchase viaticals, COSTELLO did not use the funds to purchase viaticals. Instead, COSTELLO deposited most of the funds he received into his personal bank account. In some instances, COSTELLO used investor funds to repay other investors or to pay expenses which were not disclosed to investors.

IV.

VIOLATION OF A.R.S. § 44-1841

(Offer or Sale of Unregistered Securities)

28. From about May 1999 until March 2007, Respondent offered or sold securities in the form of promissory notes or investment contracts, within or from Arizona.

29. The securities referred to above were not registered pursuant to Articles 6 or 7 of the Securities Act.

30. This conduct violates A.R.S. § 44-1841.

V.

VIOLATION OF A.R.S. § 44-1842

(Transactions by Unregistered Dealers or Salesmen)

31. From about September 16, 2003 until March 2007, Respondent offered or sold securities, in the form of promissory notes or investment contracts, within or from Arizona while not registered as a dealer or salesman pursuant to Article 9 of the Securities Act.

32. This conduct violates A.R.S. § 44-1842.

VI.

VIOLATION OF A.R.S. § 44-1991

(Fraud in Connection with the Offer or Sale of Securities)

33. In connection with the offer or sale of securities within or from Arizona, COSTELLO directly or indirectly: (i) employed a device, scheme, or artifice to defraud; (ii) made untrue statements of material fact or omitted to state material facts that were necessary in order to make the statements made not misleading in light of the circumstances under which they were made; or (iii) engaged in transactions, practices, or courses of business that operated or would operate as a fraud or deceit upon offerees and investors. COSTELLO'S conduct includes, but is not limited to, the following:

- a) COSTELLO misled offerees and investors to believe that the funds they invested with him would be used to purchase viaticals, when in fact COSTELLO did not use the funds for that purpose. Instead, COSTELLO used investors' funds to repay other investors and in some instances pay for expenses not authorized by investors;
- b) In one instance, COSTELLO showed an investor a copy of an insurance policy and represented to the investor that the policy was evidence of the investment COSTELLO had made on her behalf in viaticals, when in fact COSTELLO did not use the investor's funds to purchase a viatical;
- c) COSTELLO misled at least one offeree and investor to believe that he was registered to sell securities and a registered investment adviser, when in fact COSTELLO'S registration to sell securities in Arizona was terminated in September 15, 2003. During the relevant period, COSTELLO was not a registered investment adviser;
- d) COSTELLO misrepresented to an offeree and investor that the investment he offered was exempt from registration, when in fact it was not;

1 e) COSTELLO misrepresented to offerees and investors that the viatical investment
2 was guaranteed and risk-free, when in fact a guarantee did not exist;

3 f) COSTELLO misrepresented to offerees and investors that a state insurance fund
4 would protect them against the loss of their investment, when in fact the purpose
5 of the state insurance fund is not to protect investors against the loss of their
6 investment, nor had COSTELLO purchased viaticals on behalf of the investors.

7 34. This conduct violates A.R.S. § 44-1991.

8 **VII.**

9 **REQUESTED RELIEF**

10 The Division requests that the Commission grant the following relief:

11 1. Order COSTELLO to permanently cease and desist from violating the Securities
12 Act, pursuant to A.R.S. §44-2032;

13 2. Order COSTELLO to take affirmative action to correct the conditions resulting from
14 his acts, practices, or transactions, including a requirement to make restitution pursuant to A.R.S. §
15 44-2032;

16 3. Order COSTELLO to pay the state of Arizona administrative penalties of up to five
17 thousand dollars (\$5,000) for each violation of the Securities Act, pursuant to A.R.S. § 44-2036;

18 4. Order that the marital community of COSTELLO and L. COSTELLO be subject to
19 any order of restitution, rescission, administrative penalties, or other appropriate affirmative action
20 pursuant to A.R.S. § 25-215; and

21 5. Order any other relief that the Commission deems appropriate.

22 **VIII.**

23 **HEARING OPPORTUNITY**

24 Each respondent, including Respondent Spouse, may request a hearing pursuant to A.R.S.
25 § 44-1972 and A.A.C. R14-4-306. **If Respondent or Respondent Spouse requests a hearing, the**
26 **requesting respondent must also answer this Notice.** A request for hearing must be in writing

1 and received by the Commission within 10 business days after service of this Notice of Opportunity
2 for Hearing. The requesting respondent must deliver or mail the request to Docket Control, Arizona
3 Corporation Commission, 1200 W. Washington, Phoenix, Arizona 85007. Filing instructions may
4 be obtained from Docket Control by calling (602) 542-3477 or on the Commission's Internet web
5 site at <http://www.azcc.gov/divisions/hearings/docket.asp>.

6 If a request for a hearing is timely made, the Commission shall schedule the hearing to begin
7 20 to 60 days from the receipt of the request unless otherwise provided by law, stipulated by the
8 parties, or ordered by the Commission. If a request for a hearing is not timely made the Commission
9 may, without a hearing, enter an order granting the relief requested by the Division in this Notice of
10 Opportunity for Hearing.

11 Persons with a disability may request a reasonable accommodation such as a sign language
12 interpreter, as well as request this document in an alternative format, by contacting Linda Hogan,
13 ADA Coordinator, voice phone number 602/542-3931, e-mail lhogan@azcc.gov. Requests should
14 be made as early as possible to allow time to arrange the accommodation.

15 IX.

16 ANSWER REQUIREMENT

17 Pursuant to A.A.C. R14-4-305, if Respondent or Respondent Spouse requests a hearing, the
18 requesting respondent must deliver or mail an Answer to this Notice of Opportunity for Hearing to
19 Docket Control, Arizona Corporation Commission, 1200 W. Washington, Phoenix, Arizona
20 85007, within 30 calendar days after the date of service of this Notice. Filing instructions may be
21 obtained from Docket Control by calling (602) 542-3477 or on the Commission's Internet web site
22 at <http://www.azcc.gov/divisions/hearings/docket.asp>.

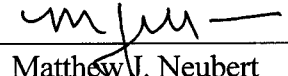
23 Additionally, the answering respondent must serve the Answer upon the Division.
24 Pursuant to A.A.C. R14-4-303, service upon the Division may be made by mailing or by hand-
25 delivering a copy of the Answer to the Division at 1300 West Washington, 3rd Floor, Phoenix,
26 Arizona, 85007, addressed to Rachel F. Strachan, Attorney.

1 The Answer shall contain an admission or denial of each allegation in this Notice and the
2 original signature of the answering respondent or respondent's attorney. A statement of a lack of
3 sufficient knowledge or information shall be considered a denial of an allegation. An allegation
4 not denied shall be considered admitted.

5 When the answering respondent intends in good faith to deny only a part or a qualification
6 of an allegation, the respondent shall specify that part or qualification of the allegation and shall
7 admit the remainder. Respondent waives any affirmative defense not raised in the Answer.

8 The officer presiding over the hearing may grant relief from the requirement to file an
9 Answer for good cause shown.

10 Dated this 23 day of September, 2008.

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13 Matthew J. Neubert
14 Director of Securities

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